A Report
to the
Montana
Legislature

Financial-Compliance Audit

Department of Public Service Regulation

For the Two Fiscal Years Ended June 30, 2016

April 2017

Legislative Audit Division

16-26

Financial-Compliance Audits

Financial-compliance audits are conducted by the Legislative Audit Division to determine whether an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) licenses.

The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by Government Auditing Standards. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2015, was issued March 29, 2016. The Single Audit Report for the two fiscal years ended June 30, 2017, will be issued by March 31, 2018. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
Room 277, State Capitol
P.O. Box 200802
Helena, MT 59620-0802

Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
Helena, MT 59620-1705

Audit Staff

Zakir Afridi
Alexa O'Dell
Jennifer Erdahl
Kelly Zwang

Reports can be found in electronic format at:
http://leg.mt.gov/audit

Fraud Hotline
(Statewide)
1-800-222-4446
(in Helena)
444-4446
ladhotline@mt.gov

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel

Deputy Legislative Auditors:
Cindy Jorgenson
Joe Murray

April 2017

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Public Service Regulation (department) for the two fiscal years ended June 30, 2016. Included in this report are three recommendations related to revenues and accounts receivable.

The department's written response to the audit is included in the audit report on page C-1. We have considered the partially-concurring response to Recommendation #1 on page three. The response indicates the department does not believe the federal revenue meets the requirements to be accrued at fiscal year-end. However, as discussed on page three of this report, the results of our audit confirm the federal revenue does meet the requirements as outlined in state accounting policy. Additionally, the response notes accruing the federal revenue at fiscal year-end would require the department to "…have the reimbursement notification/agreement or else the Office of Budget and Program Planning (OBPP) will not approve the budget amendment." These OBPP requirements do not negate the department's responsibility to accrue revenue in accordance with state accounting policy and GAAP. We maintain our position as reported.

We thank the commissioners and their staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

Room 160 • State Capitol Building • PO Box 201705 • Helena, MT • 59620-1705
Phone (406) 444-3122 • FAX (406) 444-9784 • E-Mail lad@mt.gov

Table of Contents

Elected and Administrative Officials

		Term Expires
Public Service Commission	Brad Johnson, Chair	January 2019
	Travis Kavulla, Vice Chair	January 2019
	Kirk Bushman (through December 2016)	January 2017
	Roger Koopman	January 2021
	Bob Lake	January 2021
	Tony O'Donnell (as of January 2017)	January 2021

Administrative Officials

Mandi Hinman, Administrator, Centralized Services Division

Justin Kraske, Administrator, Legal and Consumer Division

Will Rosquist, Administrator, Regulatory Division

For additional information concerning the Department of Public Service Regulation programs, contact:

Mandi Hinman, Administrator
Centralized Services Division
Public Service Regulation
PO Box 202601
Helena, MT 59620-2601
(406) 444-6175

e-mail: mhinman@mt.gov

Montana Legislative Audit Division

Financial-Compliance Audit
Department of Public Service Regulation
For the Two Fiscal Years Ended June 30, 2016

April 2017 | 16-26 | Report Summary

Under the direction of the Public Service Commission, the Department of Public Service Regulation is responsible for assuring the public receives safe, adequate, and economical utility and transportation services at reasonable rates. Our audit identified a significant deficiency in the department's internal controls related to its main source of funding, a fee on all regulated companies. As a result of this deficiency, the department does not know if it received the full amount authorized by law.

Context

In addition to assuring safe, adequate, and economical utility and transportation services, the Department of Public Service Regulation (department) regulates certain public utilities, motor carriers, railroads, and pipelines within the state, and performs safety inspections of regulated activities under the direction of the Public Service Commission.

The department is comprised of the Regulatory Division, Centralized Services Division, and Legal and Consumer Division. The department has 38.44 full-time equivalent (FTE) positions that include the five Commissioners and a Communications and Research Director. Commissioners are elected by district to serve four-year terms.

Most department funding comes from a tax on the gross operating revenue of regulated companies collected by the Department of Revenue. In fiscal years 2015 and 2016, this tax generated $3.9 million and $2.8 million in revenue, respectively. The department also received federal grant funding for the National Gas Pipeline Safety Program of $185,629 and $133,383 in fiscal years 2015 and 2016, respectively.

Results

We audited the fiscal year 2015 and 2016 financial schedules and tested compliance with state laws and federal regulations. We reviewed federal transactions, revenues received for charges for services, and expenditures disbursed for personal services. We evaluated expenditures and revenues for the State Special Revenue Funds and the Federal Special Revenue Funds to determine whether activity was recorded in the proper fund. Our audit resulted in three recommendations to the department related to accruing federal revenue, writing off accounts receivable, and internal controls.

Recommendation Concurrence	
Concur	1
Partially Concur	2
Do Not Concur	0

Source: Agency audit response included in final report.

For a complete copy of the report (16-26) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to lad@mt.gov; or check the web site at http://leg.mt.gov/audit

Report Fraud, Waste, and Abuse to the Legislative Auditor's FRAUD HOTLINE

Call toll-free 1-800-222-4446, or e-mail ladhotline@mt.gov.

Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Department of Public Service Regulation (department) for the two fiscal years ended June 30, 2016. The objectives of the audit were to:

1. Obtain an understanding of the department's internal controls to the extent necessary to support our audit of the department's financial schedules and, if appropriate, make recommendations for improvements in management and internal controls of the department.
2. Determine whether the department complied with selected state and federal laws and regulations.
3. Determine whether the department's financial schedules present fairly the results of operations and changes in fund equity for each of the two fiscal years ended June 30, 2016.

We addressed these objectives by focusing our audit effort on reviewing personal services, reimbursements, and Pipeline Safety Grant activity. We evaluated expenditures and revenues for the State Special Revenue Funds and the Federal Special Revenue Funds to determine whether activity was recorded in the proper fund. We also reviewed the accounting records for any unusual activity, such as significant changes in account balances between years and material nonroutine transactions. Throughout the audit, we reviewed and tested the department's internal controls and determined compliance with selected state laws.

Background

The Department of Public Service Regulation operates under the direction of the Public Service Commission (commission). The commission consists of five voting members who are elected on a district basis and serve a term of four years. After each general election, one of the commissioners is elected by the commission to serve as chairman until the next general election. The chairman exercises authority on behalf of the commission. The department's responsibility is to assure the public receives safe and adequate utility and transportation services at reasonable rates. The department is responsible for the regulation of certain public utilities, motor carriers, railroads, and pipelines within the state, and performs safety inspections of regulated activities under the direction of the Public Service Commission.

The department's 38.44 full-time equivalent (FTE) positions consist of five commissioners, a Communications and Research Director, and staff of the following three divisions:

- The Regulatory Division exercises general control over public utilities, including rate determination and safety standards, and exercises general supervisory control over the activities of motor carriers and railroads.
- The Centralized Services Division provides administrative support to the department.
- The Legal and Consumer Division advises the commission on matters requiring a legal interpretation or opinion, represents the commission in legal proceedings, and assists with customer complaints and issues.

The aggregate of the department's expenditure activity is shown in the Public Service Regulation Program on pages A-7 and A-8. The department is primarily funded by a fee that is levied on regulated companies to fund amounts appropriated by the legislature for a specific fiscal year as required by §69-1-402, MCA. The fee is based upon a percentage of the gross operating revenue of all activities regulated by the commission for each calendar quarter of operation.

The previous four audits resulted in no recommendations to the department.

Chapter II – Findings and Recommendations

Revenue Accruals

The department did not accrue federal revenue in accordance with state accounting policy.

The Department of Public Service Regulation (department) receives a federal grant each calendar year related to pipeline safety. The Gas Pipeline Safety Grant has been in effect since 1970 and enables the department to develop, issue, and enforce pipeline safety regulations by conducting compliance audits in conjunction with other regulatory agencies, enforcing standards, providing training, and investigating incidents. The department seeks and receives reimbursement for between 70-80 percent of its expenditures for this program every six months. The expenditures for this program are recorded in the state special revenue fund at the time they are incurred. The federal portion of the expenditures and revenues for this program are recorded in the federal special revenue fund when the reimbursements are received.

State accounting policy requires revenue to be recognized when it is realizable, measurable, earned, and available. The Gas Pipeline Safety Grant reimbursements are realizable, measurable, and earned as the reimbursement is based on known costs incurred by the department during the fiscal year and a generally predicable reimbursement rate; the reimbursements are considered available as the department has an irrevocable agreement with the federal government for the reimbursement of a portion of the program's costs. Therefore, at fiscal year-end, the amount due from the federal government should be accrued, along with a corresponding accounts receivable, in order to recognize the revenue in the correct fiscal year.

In fiscal years 2014, 2015, and 2016, the department did not accrue the estimated reimbursement revenue and accounts receivable, or move the corresponding expenditures into the federal special revenue fund for the months of January through June at fiscal year-end. The amounts were recorded in the subsequent fiscal years when the reimbursement was received, which resulted in the federal revenues in the federal special revenue fund being overstated by approximately $1,800 and understated by approximately $2,500 in fiscal years 2015 and 2016, respectively, assuming a 70 percent reimbursement rate in all fiscal years. However, the risk exists that, in any given year, the misstatements could be significantly higher.

Department staff stated they do not accrue revenue at fiscal year-end as they do not know the amount they will be reimbursed. However, the department does have

enough experience receiving reimbursements for this grant to estimate the amount of the reimbursement at fiscal year-end.

Recommendation #1

We recommend the Department of Public Service Regulation comply with state policy by accruing federal revenue at fiscal year-end.

Internal Controls Over the Gross Operating Revenue Fee

The department does not have internal controls in place over the fee calculated and collected on its behalf by the Department of Revenue.

The department is primarily funded by a quarterly fee levied on all regulated companies within the state. This fee is based on the percentage of gross operating revenue of all activities regulated by the Public Service Commission and calculated and collected by the Department of Revenue on behalf of the department pursuant to state law. The Department of Revenue deposits the collected fee into a state special revenue fund shared with the department. The department records expenditures in this shared fund throughout the fiscal year. During the fiscal year-end closing process, the cash collected and deposited into the shared fund by the Department of Revenue under its business unit is moved to the department's business unit via a direct entry to fund balance. In fiscal years 2015 and 2016, the department received approximately $3,900,000 and $2,800,000, respectively, from the Department of Revenue.

State policy designates management as responsible for establishing and maintaining the internal controls for the agency. Additionally, management's responsibility includes establishing internal control policies and procedures designed to safeguard agency assets, check the accuracy and reliability of financial data, promote operational efficiency, and encourage adherence to prescribed managerial policies and compliance with applicable laws and regulations.

While the department monitors the cash balance in the shared fund weekly to ensure it will cover the department's current operating expenses, the department does not have any internal controls in place to ensure the correct rate is being charged or that the amount of the fee collected and deposited by the Department of Revenue is correct. Without internal controls, department personnel do not know if they are

receiving all of the revenue the department is entitled to under state law. In addition, state policy requires a timely reconciliation of all revenues collected by parties outside of the department.

Department staff stated they trust and rely on the Department of Revenue to have controls in place to collect the fee correctly and deposit all of the money into the shared state special revenue fund.

As this fee is the main source of operating revenue for the department, it is in their best interest to implement controls to ensure the amount recorded is accurate and complete.

RECOMMENDATION #2

We recommend the Department of Public Service Regulation develop and implement internal controls to ensure the completeness and accuracy of the fee charged and collected on the department's behalf.

Writing Off Accounts Receivable

The department does not transfer accounts receivable in accordance with state accounting policy.

State law requires the department to advertise certain commission proceedings in order to make the public aware of potential actions regarding regulated companies. The department initially pays for the costs of the advertisements and, pursuant to state law, bills the pertinent regulated companies at a later date. Although the department makes several attempts to collect these receivables, a portion are unable to be collected.

State accounting policy requires agencies to transfer receivables to the Department of Revenue or an outside collection agency after all reasonable attempts have been made by the agency and the receivable is still uncollected. Instead of transferring uncollected receivables to the Department of Revenue or an outside collection agency, the department periodically writes off the receivables they are unable to collect. In fiscal year 2015, the department wrote off approximately $2,800 in uncollected receivables. In fiscal year 2016, the department did not write off any receivables.

Department staff stated they cannot transfer receivables to the Department of Revenue as they often do not have the tax identification number for the regulated company,

which is required by the Department of Revenue. Additionally, staff stated that as the receivable amounts are small, it may be too expensive to seek outside assistance in collecting them.

While it is true the cost of an outside collection agency may be prohibitive, there are options available other than simply writing off the receivable. One such option is using the Department of Revenue's offset system within the statewide accounting system, which allows the Department of Revenue to intercept payments made by the state to outside parties. For example, if the regulated company owing the department provides another state agency with a service as a vendor, this offset system will intercept any payments made to the regulated company by the other state agency and send them to the department to apply to the uncollected receivable. Because the department does not solicit the tax identification numbers for the regulated companies associated with the receivables, they are currently unable to take further action to collect the receivables or transfer them over to the another party. As a result, the department is not receiving all of the revenue it is entitled to.

Per discussion with department staff, their procedures could be modified in order to collect the necessary tax identification number via forms such as the W-9, Request for Taxpayer Identification and Certification. This information could be used to take further collection action for uncollected accounts receivable. This change would result in minimal costs to the department and enable compliance with state accounting policy, as the use of the offset system offered by the Department of Revenue requires no upfront costs as the fee is a percentage of any amounts collected.

Recommendation #3

We recommend the Department of Public Service Regulation:

A. *Implement procedures to collect tax identification numbers from regulated companies who have proceedings before the commission, and*

B. *Comply with state policy and transfer receivables to the Department of Revenue or an outside collection agency after making all reasonable attempts to collect the receivable.*

Independent Auditor's Report and Department Financial Schedules

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel

Deputy Legislative Auditors:
Cindy Jorgenson
Joe Murray

Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

Introduction
We have audited the accompanying Schedules of Changes in Fund Equity, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Public Service Regulation for each of the fiscal years ended June 30, 2016, and 2015, and the related notes to the financial schedules.

Management's Responsibility for the Financial Schedules
Management is responsible for the preparation and fair presentation of these financial schedules in accordance with the regulatory format prescribed by the Legislative Audit Committee, based on the transactions posted to the state's accounting system without adjustment; this responsibility includes recording transactions in accordance with state accounting policy; and designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of the financial schedules that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express opinions on these financial schedules based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial schedules. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial schedules, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the department's preparation and fair presentation of the financial schedules in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the financial schedules.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Room 160 • State Capitol Building • PO Box 201705 • Helena, MT • 59620-1705
Phone (406) 444-3122 • FAX (406) 444-9784 • E-Mail lad@mt.gov

Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles
As described in Note 1, the financial schedules are prepared from the transactions posted to the state's primary accounting system without adjustment, in the regulatory format prescribed by the Legislative Audit Committee. This is a basis of accounting other than accounting principles generally accepted in the United States of America. The financial schedules are not intended to, and do not, report assets and liabilities.

The effects on the financial schedules of the variances between the regulatory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinions on U.S. Generally Accepted Accounting Principles
In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles" paragraph, the financial schedules referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the department as of June 30, 2016, and June 30, 2015, or changes in financial position for the years then ended.

Unmodified Opinions on Regulatory Basis of Accounting
In our opinion, the Schedules of Changes in Fund Equity, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out, presents fairly, in all material respects, the results of operations and changes in fund equity of the Department of Public Service Regulation for each of the fiscal years ended June 30, 2016, and 2015, in conformity with the basis of accounting described in Note 1.

Other Reporting Required by Government Auditing Standards
In accordance with *Government Auditing Standards*, we have also issued our report dated January 13, 2017, on our consideration of the Department of Public Service Regulation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department's internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

January 13, 2017

DEPARTMENT OF PUBLIC SERVICE REGULATION
SCHEDULE OF CHANGES IN FUND EQUITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2016

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund
FUND EQUITY: July 1, 2015	$ 0	$ 1,207,716	$ 0
ADDITIONS			
Budgeted Revenues & Transfers-In		34,224	133,383
Nonbudgeted Revenues & Transfers-In	11,000	96	80
Direct Entries to Fund Equity	(11,000)	2,818,868	
Total Additions	0	2,853,187	133,463
REDUCTIONS			
Budgeted Expenditures & Transfers-Out		3,638,577	133,463
Prior Year Expenditures & Transfers-Out Adjustments		(877)	
Total Reductions	0	3,637,699	133,463
FUND EQUITY: June 30, 2016	$ 0	$ 423,204	$ 0

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF PUBLIC SERVICE REGULATION
SCHEDULE OF CHANGES IN FUND EQUITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

	State Special Revenue Fund	Federal Special Revenue Fund
FUND EQUITY: July 1, 2014	$ 999,708	$ 0
ADDITIONS		
Budgeted Revenues & Transfers-In	29,830	185,517
Nonbudgeted Revenues & Transfers-In	70	113
Prior Year Revenues & Transfers-In Adjustments	300	
Direct Entries to Fund Equity	3,913,238	
Total Additions	3,943,439	185,629
REDUCTIONS		
Budgeted Expenditures & Transfers-Out	3,738,045	185,629
Nonbudgeted Expenditures & Transfers-Out	(2,614)	
Total Reductions	3,735,431	185,629
FUND EQUITY: June 30, 2015	$ 1,207,716	$ 0

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF PUBLIC SERVICE REGULATION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2016

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS				
Licenses and Permits		$ 10,675		$ 10,675
Taxes			$ 80	80
Charges for Services		23,644		23,644
Fines and Forfeits	$ 11,000			11,000
Federal			133,383	133,383
Total Revenues & Transfers-In	11,000	34,319	133,463	178,782
Less: Nonbudgeted Revenues & Transfers-In	11,000	96	80	11,176
Prior Year Revenues & Transfers-In Adjustments				0
Actual Budgeted Revenues & Transfers-In	0	34,224	133,383	167,607
Estimated Revenues & Transfers-In		50,002	218,001	268,003
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ 0	$ (15,778)	$ (84,618)	$ (100,396)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS				
Licenses and Permits		$ (4,326)		$ (4,326)
Charges for Services		(11,452)		(11,452)
Federal			$ (84,618)	(84,618)
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ 0	$ (15,778)	$ (84,618)	$ (100,396)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF PUBLIC SERVICE REGULATION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

	State Special Revenue Fund	Federal Special Revenue Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS			
Licenses and Permits	$ 7,255		$ 7,255
Taxes		$ 113	113
Charges for Services	22,946		22,946
Federal		185,517	185,517
Total Revenues & Transfers-In	30,201	185,629	215,830
Less: Nonbudgeted Revenues & Transfers-In	70	113	183
Prior Year Revenues & Transfers-In Adjustments	300		300
Actual Budgeted Revenues & Transfers-In	29,830	185,517	215,347
Estimated Revenues & Transfers-In	46,000	287,003	333,003
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (16,170)	$ (101,486)	$ (117,656)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS			
Licenses and Permits	$ (4,045)		$ (4,045)
Charges for Services	(12,125)		(12,125)
Federal		$ (101,486)	(101,486)
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (16,170)	$ (101,486)	$ (117,656)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF PUBLIC SERVICE REGULATION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2016

	Public Service Regulation Program	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT		
Personal Services		
Salaries	$ 2,337,808	$ 2,337,808
Employee Benefits	753,219	753,219
Total	3,091,027	3,091,027
Operating Expenses		
Other Services	127,998	127,998
Supplies & Materials	57,434	57,434
Communications	63,289	63,289
Travel	102,365	102,365
Rent	234,498	234,498
Repair & Maintenance	4,411	4,411
Other Expenses	84,389	84,389
Total	674,384	674,384
Capital Outlay		
Buildings	(323)	(323)
Total	(323)	(323)
Debt Service		
Capital Leases	6,075	6,075
Total	6,075	6,075
Total Expenditures & Transfers-Out	$ 3,771,162	$ 3,771,162
EXPENDITURES & TRANSFERS-OUT BY FUND		
State Special Revenue Fund	$ 3,637,699	$ 3,637,699
Federal Special Revenue Fund	133,463	133,463
Total Expenditures & Transfers-Out	3,771,162	3,771,162
Less: Nonbudgeted Expenditures & Transfers-Out		
Prior Year Expenditures & Transfers-Out Adjustments	(877)	(877)
Actual Budgeted Expenditures & Transfers-Out	3,772,040	3,772,040
Budget Authority	4,365,678	4,365,678
Unspent Budget Authority	$ 593,638	$ 593,638
UNSPENT BUDGET AUTHORITY BY FUND		
State Special Revenue Fund	$ 513,535	$ 513,535
Federal Special Revenue Fund	80,103	80,103
Unspent Budget Authority	$ 593,638	$ 593,638

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF PUBLIC SERVICE REGULATION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

	Public Service Regulation Program	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT		
Personal Services		
Salaries	$ 2,434,271	$ 2,434,271
Employee Benefits	785,007	785,007
Total	3,219,277	3,219,277
Operating Expenses		
Other Services	89,995	89,995
Supplies & Materials	105,035	105,035
Communications	73,604	73,604
Travel	102,679	102,679
Rent	236,598	236,598
Repair & Maintenance	6,878	6,878
Other Expenses	80,596	80,596
Total	695,386	695,386
Equipment & Intangible Assets		
Total		
Capital Outlay		
Buildings	323	323
Total	323	323
Debt Service		
Capital Leases	6,075	6,075
Total	6,075	6,075
Total Expenditures & Transfers-Out	$ 3,921,060	$ 3,921,060
EXPENDITURES & TRANSFERS-OUT BY FUND		
State Special Revenue Fund	$ 3,735,431	$ 3,735,431
Federal Special Revenue Fund	185,629	185,629
Total Expenditures & Transfers-Out	3,921,060	3,921,060
Less: Nonbudgeted Expenditures & Transfers-Out	(2,614)	(2,614)
Prior Year Expenditures & Transfers-Out Adjustments		
Actual Budgeted Expenditures & Transfers-Out	3,923,674	3,923,674
Budget Authority	4,396,096	4,396,096
Unspent Budget Authority	$ 472,422	$ 472,422
UNSPENT BUDGET AUTHORITY BY FUND		
State Special Revenue Fund	$ 218,871	$ 218,871
Federal Special Revenue Fund	253,551	253,551
Unspent Budget Authority	$ 472,422	$ 472,422

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-9.

Department of Public Service Regulation

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 2016

1. Summary of Significant Accounting Policies

Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund categories (General Fund, State Special Revenue and Federal Special Revenue). In applying the modified accrual basis, the department records:

- Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual and sick leave when used or paid.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format was adopted by the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The department uses the following funds:

Governmental Fund Category

- **General Fund** – to account for Motor and Pipeline Carrier civil penalties issued by the Commission.
- **State Special Revenue Fund** – to account for proceeds of specific revenue sources that are legally restricted to expenditures for specific state program purposes. Department State Special Revenue Funds include a fund to account for general operating revenues and expenditures and a fund to account for Qwest performance monitoring.
- **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Department Federal Special Revenue Funds account for the Federal Natural Gas Safety Program and American Recovery and Reinvestment Act funds.

2. Direct Entries to Fund Equity

Direct entries to fund equity in the State Special Revenue fund includes entries generated by Statewide Accounting, Budgeting, and Human Resources System to reflect the flow of resources within individual funds shared by separate agencies.

The general fund is involved only when it comes to Motor and Pipeline Carrier violations. The majority of the direct entries to fund balance in the State Special Revenue Fund relates to the collection of utility gross operating tax by the Montana Department of Revenue. This tax is the main source of funding for the department and is based upon a percentage of the gross operating revenue of all activities regulated by the commission for each calendar quarter of operation.

3. Revenue Estimates

PSC revenue estimates are based on our history of revenue estimates and how much revenue we anticipate receiving through the tax on gross operating revenues of the utilities (State Special Revenue) and the amount of the grant that we will be receiving to fund our Pipeline Program (Federal Special Revenue).

4. Unspent Budget Authority

PSC unspent budget authority is the result of vacant positions as well as lower than expected retirement payouts, consulting expenditures, IT expenditures, and Pipeline Safety program federal expenditures during both fiscal years.

Report on Internal Control and Compliance

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel

Deputy Legislative Auditors:
Cindy Jorgenson
Joe Murray

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance with *Government Auditing Standards*

The Legislative Audit Committee
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Schedules of Changes in Fund Equity, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Public Service Regulation for each of the fiscal years ended June 30, 2016, and 2015, and the related notes to the financial schedules, and have issued our report thereon dated January 13, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial schedules, we considered the Department of Public Service Regulation's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial schedules, but not for the purpose of expressing an opinion on the effectiveness of the Department of Public Service Regulation's internal control. Accordingly, we do not express an opinion on the effectiveness of Department of Public Service Regulation's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial schedules will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal controls was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material

Room 160 • State Capitol Building • PO Box 201705 • Helena, MT • 59620-1705
Phone (406) 444-3122 • FAX (406) 444-9784 • E-Mail lad@mt.gov

weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described below, that we consider to be a significant deficiency:

Summary of Deficiencies in Internal Control		
Subject	**Type of Deficiency**	**Page in 16-26 Report**
Internal Controls over the Gross Operating Revenue Fee	Significant Deficiency	4

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department of Public Service Regulation financial schedules are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Department of Public Service Regulation Response to Findings

Department of Public Service Regulation response to the findings identified in our audit are described on page C-1 of this report. The department's response was not subjected to the auditing procedures applied in the audit of the financial schedules and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the department's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

January 13, 2017

Department of Public Service Regulation

Department Response

Montana Public Service Commission

March 27, 2017

Angus Maciver
Legislative Auditor
Room 160
State Capitol Building
P.O. Box 201705
Helena, MT 59620-1705

RECEIVED
MAR 27 2017
LEGISLATIVE AUDIT DIV.

Dear Mr. Maciver,

Please find enclosed the responses of the Montana Public Service Commission to the 2015-2016 Financial Audit. Please do not hesitate to contact us if you have questions or require further information.

Sincerely,

Brad Johnson, Chairman
Montana Public Service Commission

Finding: The Department did not accrue federal revenue in accordance with state accounting policy.
Agency Response: Partially Concur

Per MOM 320 Revenues Receivables Debt, revenues are to be recognized when they meet all four of the following criteria (agency responses address each item):

1. **The revenue is realizable. Revenue is considered realizable when it is probable the amount will be collected.**
2. **The revenue is measurable. Revenue is considered measurable and realizable if:**
   - **The precise amount is known because the transaction is completed, or**
   - **There is enough information to provide a reasonable, although not necessarily precise, estimate of the net realizable revenue to be received. Experience often provides a basis for determining a reasonable estimate.**
3. **The revenue has been earned. Revenue is considered to have been earned when the exchange of goods or services has taken place. Refer to the specific guidance below for more information on when multi-year license and permit revenue should be considered earned. If revenue is unearned (including multi-year license and permit revenue), it should be recorded as unearned revenue.**
4. **The revenue is available. Available means collectible within the current fiscal year or soon enough thereafter to be used to pay liabilities of the current fiscal year. Revenue is considered to be available if any of the following criteria are met:**
   - **It has actually been received and deposited in the state treasury during the fiscal year.**
   - **The revenue is in the possession of a collecting agent on the last day of the fiscal year (June 30) and will be received by the State within 60 days after June 30.**
   - **The revenue is due for the fiscal year ending June 30, but the payer is allowed an administrative lead time of no more than 60 days to process the paperwork to calculate the liability and make the remittance to the State.**
   - **The revenue is normally received within 60 days after June 30, but due to highly unusual circumstances it has not been received by the State within 60 days after June 30. It should be received by the agency shortly after the 60-day period.**
   - **The revenue is for federal funds with reimbursable grants and a legal, irrevocable commitment from the federal government exists to pay expenses incurred.**

The federal reimbursement (reimbursement) is mostly realizable, since it is realized that we have received the reimbursement in the past and it is probable that we will continue to receive it, however, we do not feel that the reimbursement is necessarily measurable, has necessarily been earned, or is available.

Measurable: At fiscal year end, the transactions relating to our Pipeline Safety Program have been completed, therefore, we know the exact amount of expenses incurred. However, at that same time, the reimbursement is not measureable since we have not received the reimbursement notification or any type of indication of what the reimbursement amount will be.

Earned: Again, we can only assume it probable that we will receive a reimbursement, even though the revenue is theoretically earned when the expenses began to incur.

Available: We do not receive the payment agreement/notice or reimbursement until roughly 3-5 months after fiscal year end. Because of this, the revenue is not available, has not been deposited in the state treasury during the fiscal year, and will not be received by the state within 60 days of fiscal year end.

Further, since at fiscal year end we do not have the reimbursement or even notification of if and/or when we will even receive a reimbursement and/or how much the reimbursement will even be, that even though we have established that the reimbursement is probable, we feel there is not enough information at fiscal year end to qualify as an irrevocable commitment.

If we were to accrue the reimbursement, we would then need to move the corresponding expenditures for the months of January through June into the federal special revenue fund at fiscal year end. So, in order to do this, we would need sufficient authority and/or appropriation for those expenditures. Due to the increasing reimbursement over the past few years, we have not had sufficient authority and/or appropriation, therefore, a budget amendment through a BCD has been necessary. However, in order to get a budget amendment done, we have to have the reimbursement notification/agreement or else the Office of Budget and Program Planning (OBPP) will not approve the budget amendment. Without the agreement, the OBPP doesn't recognize that we have enough information to establish authority and/or appropriation for expenditures, nor do they recognize an irrevocable agreement in this situation.

Also, the reimbursement being based on calendar year rather than fiscal year makes a difference. For example, if we receive the reimbursement for the first half of calendar year 2015 expenditures in October 2015 (the beginning of fiscal year 2016), we could then request a budget amendment for calendar year 2015 expenses that were incurred in fiscal year 2015 and fiscal year 2016. But, since we will not receive the calendar year 2016 reimbursement until October 2016 (the beginning of fiscal year 2017), we would not have the authority and/or appropriation to record any calendar year 2016 expenses in fiscal year 2016 (we can't use calendar year 2015 authority/appropriation for calendar year 2016 expenses).

Further, if we record the revenue estimate at fiscal year end, but are not able to record the corresponding expenditures, our revenue and expenditures would not net to zero and we would have an improper fund equity balance in a federal fund at fiscal year end.

Recommendation: That the Department of Public Service Regulation comply with state policy by accruing federal revenue at fiscal year end.

Corrective Action Plan:

In the current legislative session, we requested and so far have been granted an additional $100,000 in authority for each year of the biennium. We requested this increase due to this very issue, so we will have the authority at fiscal year end, rather than months later, so we will be fully able to accrue federal revenue at fiscal year end.

Finding: The Department does not have internal controls in place over the fee calculated and collected on its behalf by the Department of Revenue.
Agency Response: Partially Concur

MCA 69-1-402. Funding of department of public service regulation:
(1) All fees collected under this section and any other fees, except as provided in 69-1-114(3), must be deposited in an account in the state special revenue fund to the credit of the department. An appropriation to the department may consist of a base appropriation for regular operating expenses and a contingency appropriation for expenses due to an unanticipated caseload.
(2) In addition to all other licenses, fees, and taxes imposed by law, all regulated companies shall, within 30 days after the close of each calendar quarter, pay to the department of revenue a fee based on a percentage of gross operating revenue reported pursuant to 69-1-223(2)(a), as determined by the department of revenue under 69-1-403.
(3) The amount of money that may be raised by the fee on the regulated companies during a fiscal year may not be increased, except as provided in 69-1-224(1)(c), from the amount appropriated to the department by the legislature for that fiscal year, including both base and contingency appropriations. Any additional money required for operation of the department must be obtained from other sources in a manner authorized by the legislature.

The Constitution provides for a tax on gross revenues associated with regulated activities, which is collected by the Department of Revenue (DOR) and deposited into the state special revenue account that funds Public Service Commission (PSC) operations. When the legislature sets PSC appropriation, that amount is applied to the regulated revenues to calculate the tax rate that funds the PSC.

August of each year, we provide the DOR with reports showing our expenditures from the previous fiscal year and appropriation for the current fiscal year. At that same time, the DOR receives gross operating revenue information they need from regulated utilities. With the information on those reports, the new tax rate is calculated (the appropriation is the numerator and the regulated revenues is the denominator). A key piece of this funding mechanism is that any unspent balance is automatically deducted from the appropriation.

Once we are made aware of the new tax rate, I review the calculation with staff from the DOR ensure my full understanding and concurrence of the calculation made. Then, a work session at a PSC business meeting is scheduled and commissioners discuss and approve the new tax rate for the PSC as well as the Montana Consumer Counsel (MCC). Once approval is granted, final orders are issued implementing the new tax rates for the next year. Each new tax period is from October 1 through September 30 and, as I stated previously, any unspent balance from prior year is automatically deducted from the appropriation amount and reduces the next years' calculation.

MOM Policy 320, Section XIIC, 2 - Reconciliation of agent-collected revenues: Agencies are required to perform a timely reconciliation of all agent-collected revenues. At a minimum, this reconciliation must be performed on a monthly basis.

Each week, we monitor how much cash we have received from the DOR to make sure it's sufficient to cover what we have spent at any given time. We do this by running a trial balance query to determine what our current cash balance is. If at any time we are negative cash for 7 days we have to get a loan from the Department of Administration This has not happened in many years.

Recommendation: That the Department of Public Service Regulation develop and implement internal controls to ensure the completeness and accuracy of the fee charged and collected on the department's behalf.

Corrective Action Plan:

The PSC will work with staff from the DOR to assist in developing a process for us to independently determine the completeness and accuracy of the fee charged and collected on our behalf, therefore, we can develop and implement our own internal controls relating to this issue as well as relating to us performing a timely (monthly) reconciliation to confirm all agency-collected revenues. We intend to have a process in place before the next tax rate calculation, which will take place in September 2017.

Finding: The Department does not transfer accounts receivables in accordance with state accounting policy.

Agency Response: Concur

We have discussed this issue internally and have determined that 1) we should require W-9's or deposits from parties that come before the commission in Transportation issues and that 2) often times the amounts in question would far under-exceed the cost of utilizing and paying a collection agency.

We would have to make sure that all W-9's are pulled from the application materials before the applications were posted to our website, since confidentiality would be a factor here.

Recommendations: That the Department of Public Service Regulation A) Implement procedures to collect tax identification numbers from regulated companies who have proceedings before the commission, and B) Comply with state policy and transfer receivables to the Department of Revenue or an outside collection agency after making all reasonable attempts to collect the receivable.

Corrective Action Plan:

Because we have visited this issue in the past and the fact that the amount of our receivables appears to be increasing as of late, we will pursue this issue again with PSC management, including our Chief Legal Counsel, and will explore all of our options to get this resolved to comply with our audit recommendation, taking Commission action if necessary. We anticipate having a process in place at the time we go before the Legislative Audit Committee.